

## The Bulgarian Economy, October 2006

(Summary of the report by the Center for Economic Development)

- Total economic growth continues at relatively high values and in 2006 we expect it to stand at above 6 per cent on a year over year basis.
- The ESTAT index of business climate registers negligible seasonal decline, but overall the business gives positive assessment of business environment changes.
- Deterioration of the current account deficit continues but foreign direct investments (FDI) cover a higher portion of the deficit against the same period of last year and in 2006 we expect a record-breaking FDI level at above EUR 3 b.
- The tendency of higher growth in exports against growth in imports persists, exports to the Balkan countries registering the highest values – more than 50 per cent growth from the beginning of 2006 till August against the same period of last year.
- The jump of energy resource prices makes Russia a top importer for Bulgaria, raising again the strategic issue of energy supplies diversification.
- Emerging deflation in food prices offsets the increase in administratively regulated prices, which allows us to project annual inflation at below 5 per cent against December of last year.
- Anticipated lower, down to 10 per cent, corporate tax rate since the beginning of next year deserves a very positive assessment, but budget redistribution remains at very high levels.
- The lack of knowledge and skills in the public administration and the business to absorb resources from the EU structural funds raises concerns.
- In a sectoral aspect, deteriorations in the railway transport and lower growth in tourism against the same period of last year are annoying.
- The preparedness of agriculture to apply EU's Common Agricultural Policy remains doubtful.

### Macroeconomic Dynamics



We expect *economic growth* to go up above 6 per cent in 2006. Data for the first six months of the year **about gross domestic product growth (6.1 per cent) and the monthly indicators till September confirm our expectations of higher macroeconomic dynamics.** Growth in the third quarter will be higher against the same period of last year and will probably accelerate against the previous quarters of 2006. The upward trend in consumer demand will persist. We expect also that the contribution of growth in investments to total economic growth will increase and will

create preconditions for sustainable growth in the exports of goods and services.

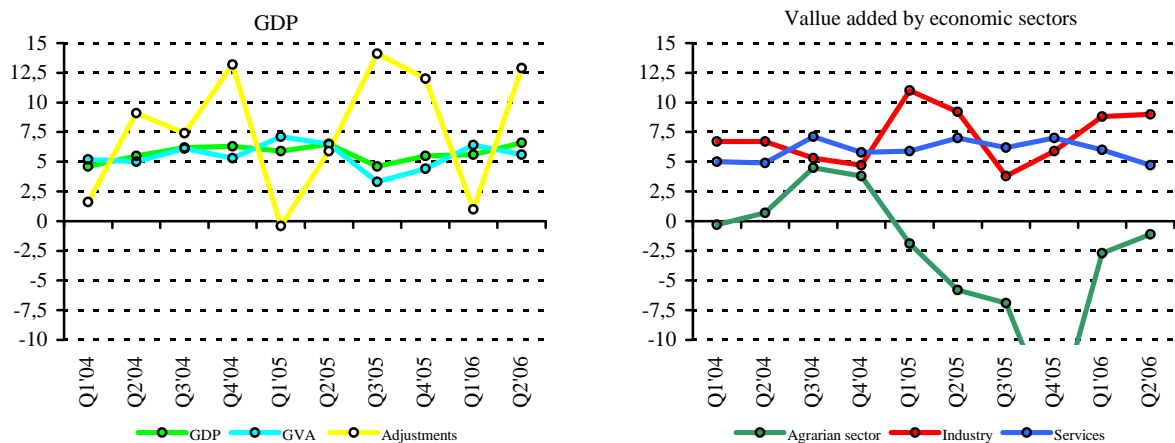
↑  
business  
climate

The Bulgarian business climate has been improving since the beginning of 2006. **Most promising is the fast improvement of the business climate in industry indicator.** Industrial capacity load increases as well – up 8 percentage points, such development being registered for the first time – for three months only, from April till July, the capacity load was up from 64 to 72 per cent.

↓  
GVA  
growth

However, one has to be careful when assessing the quality of total economic growth which until mid 2006 remains similar to that in the same period of last year (respectively 6.1 and 6.2 per cent). Some caution on the *demand* side is also necessary because of a **delayed growth in total value added for the economy (6.8 per cent in the first half of last year against 6 per cent now), which is attributable to a delayed growth in industry (down from 10.1 to 8.9 per cent) and services (down from 6.5 to 5.3 per cent).** Delayed total growth in the private sector (down from 10 to 7.9 per cent) is attributable also to a continuously shrinking agrarian sector. Nevertheless, conjuncture indicators show promise that in the third quarter the private sector will register higher dynamics against a year back.

**Figure 1. Produced GDP components, real growth, %**



Source: NSI

Investments remain the component with the highest dynamics in total Bulgarian economic growth on the *demand* side. Investment dynamics not only contributes to total economic growth in the first half of 2006, to a large extent it is also a guarantee of future growth. **Growth in investments is**

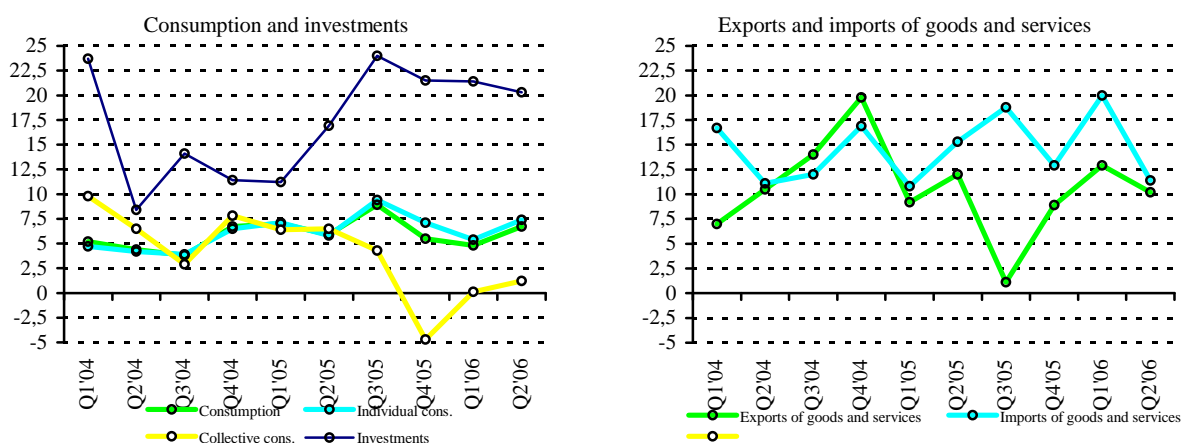
↑  
growth in  
investments

notably higher against the same period of last year and remains stable at levels above 20 per cent for four quarters in a row. While the contribution of individual consumption has the highest value (5.2 percentage points), the contribution of investments in total economic growth in the first half of 2006 (4.6 percentage points) is more significant in a long-term perspective. Besides, while the contribution of consumption decreases, the contribution of investments in total economic growth increases and in the first six months stands at higher values compared to previous years.

↑  
contribution  
of exports

While in the first quarter of 2006 the net contribution of the exports of goods and services in total economic growth deteriorated significantly to negative 7.3 percentage points, in the second quarter delayed real growth in imports (down from 20 per cent in the first quarter to 11 per cent in the second quarter) resulted in improved negative balance of goods and services in the quarter and a slight decrease in the negative contribution of foreign trade in half-year growth (down from 5.8 percentage points in the past year to 5 percentage points in the first half of 2006). **A positive assessment can be given to the higher growth in the contribution of exports (up from 4.2 percentage points in 2005 to 7 percentage points in the first half of 2006) against growth in the negative contribution of imports (up from 10 percentage points in 2005 to 12 percentage points in the first half of 2006).**

Figure 2. Used GDP components, real growth, %



Source: NSI

↓  
current  
account  
deficit

In the first eight months of 2006 the current account deficit went up to 7.9 per cent of GDP against 5.1 per cent in the same period of last year. It has

to be noted that the 2.8 percentage points contribution of the trade balance in the structure of this relative deterioration is lower (0.9 percentage points) compared to the aggregate relative deterioration of the positive balances in services, income and transfers (1.9 percentage points).

↓  
positive balance  
in services

The positive changes in foreign trade flow dynamics (FOB) are attributable to a notably accelerated nominal growth in exports (up to 30 per cent against 18.9 per cent in the first eight months of 2005) and a slower pace of increase in imports (up from 26.0 per cent to 27.1 per cent). Thus imports register higher growth against exports by almost 3 percentage points. **The deteriorated positive balance in services is attributable to a negative change of the balance in transport services (from positive to negative values). The positive balance in travels registers again negligible improvement.** Unfavorable for the balance in tourism is the fact that revenues from travels of foreigners to Bulgaria register slower growth (up 5.5 per cent) against growth in Bulgarians' spending for travels abroad (up 10.7 per cent). The net inflow of funds to Bulgaria under "Income" and "Current Transfers" remains on a downward path.

*FDI's cover of the current account deficit* registers slight improvement (up from 89 per cent in the first eight months of 2005 to 92 now) which is attributable to a growth in foreign direct investments which are up 80 per cent.

↑↓  
trade deficit

The upward trend *in the trade deficit* will persist after the accession to the EU. Higher domestic consumption, business activity and continuing inflow of foreign investments make foreign trade deficit less risky. **While it remains high (EUR 3.8 b in the first eight months of 2006), its nominal growth on a year-over-year basis slows down and stands at twice lower levels (21.7 per cent) against the first quarter of the year (43.7 per cent).** The good news is that growth in exports is higher, though negligibly yet, compared to growth in imports (respectively 30 and 27 per cent).

↑  
exports to  
Balkan countries

The different price dynamics on international markets is at the root of the different growth in exports of individual commodity groups (varying from 7.8 per cent in consumer goods to 87.3 per cent in energy resources) and results in changes in the commodity structure of exports. Higher *exports* of raw materials and energy resources are attributable mainly to higher prices, whereas exports of investment and consumer goods increase mainly in terms of quantity. Exports of transport vehicles and spares account for the highest share in growth of investment goods. Clothes and shoes still account for over 50 per cent of exports of consumer goods and despite the strong competition of Asian producers they register growth though at a moderate pace (4.7 per cent in the first eight months of 2006). The geographic structure of exports is changing as a result of massive penetration of neighbor markets and while **exports to the EU register moderate growth (up 23 per cent) exports to the Balkan countries are up almost 50 per**

cent. About half of the exports to the Balkan countries are going to Turkey which is already ranking first among the consumers of Bulgarian export products, accounting for over 11 per cent of total exports.

Increasing prices of energy resources and raw materials result in a higher share of energy resources and raw materials in total imports (about 60 per cent) while the share of investment and consumer goods registers decrease despite real growth in imports. **The changed geographical structure of imports is attributable to a high growth in imports from Russia (up 63 per cent) resulting in a higher share of this country (up to 18.9 per cent) and ranking Russia first among importers, followed by Germany, Italy, Turkey and Greece.** Despite the apprehensions of inflow of cheap imports from Asia, growth in imports from the region is similar to total growth, keeping the share of imports from Asia at 10 per cent.

The future liberalization of the trade with the EU threatens food sector products in the first place, whereas industry will hardly be affected.

In the first eight months of 2006 *foreign direct investments (FDI)* in Bulgaria amount to more than EUR 1 755 m (7.3 per cent of GDP estimates), accounting for 82 per cent growth against the same period of 2005. **The Bulgarian Investment Agency projects 2006 investments at EUR 3 b against EUR 2.4 b in 2005.** All data indicate that international investors still view Bulgaria as an attractive destination. The higher monthly values of investments in equity against investments in “Other Capital” (intercompany credits) are viewed as a positive trend. FDI inflow is still directed to the services sector (including trade). We expect that future investors’ interest will be redirected from services to industry which currently accounts for about ¼ of total investments. Creating favorable conditions to attract foreign investments is dependable on fast implementation of public administration reform and facilitation of regulatory regimes, because **burdensome and complex procedures, the large volume of required documents, analyses, permits, etc., which are highly time and fund consuming, represent the main barrier to a mass penetration of FDI.** Bulgaria’s potential to attract foreign direct investments is not at all exhausted – our coming EU membership, political and financial stability, harmonized legislation and lower taxes will continue to encourage the investment activity.

**In the first nine months of 2006 the accumulated increase in consumer prices is 2.5 per cent, with decreasing food prices (down 3.2 per cent) and more notable upward movement of non-food prices (up 10.3 per cent). Even more favorable for consumers is the price dynamics of the so-called small consumer basket<sup>1</sup>, which registers 1.1 per cent deflation against December of last year and here again most notable is the contribution of decreasing food prices (3.6 per cent).** The lack of



<sup>1</sup> Specially monitored by NSI 100 socially useful and vital goods and services, weighted with the expenditures of the 20 per cent of the lowest income households.

↔  
moderate  
inflation

officially published preliminary calculations of the timing and effect of expected changes in administratively regulated prices makes it difficult to estimate total inflation, but **most probably accumulated till year-end increase will be lower and will hardly go above 5 per cent, mainly because of a weaker than expected market inflation dynamics.**

**Total increase of producer prices (export and domestic market) accumulated till August is 10.2 per cent against December 2005. Domestic market prices move up at a slightly smaller pace.** Following international price dynamics, metal ore mining and metal production and casting register the highest price dynamics.

NSI's business surveys do not reveal synonymous conjuncture indications of expected significant market pressure on consumer prices in the last three months of 2006. **Producer prices in industry will probably remain unchanged,** according to the projections of 85 per cent of the industrial enterprises interviewed in September.

↑  
employment

The high economic growth in the first half of 2006 is accompanied by **improved *number of employed – number of unemployed* ratio (8.4 per cent in the same period of last year against 9.7 per cent now) and delayed growth in productivity (respectively 4.5 per cent down to 2 per cent).**

The tendency of **sustainable decrease of unemployment** persists. While May was the first month since 2001 when the Employment Agency (EA) reported monthly level of registered unemployment below 10 per cent, July was the first month when the EA coefficient went below 9 per cent, continuing fast downward to 8.44 per cent in September.

We give a positive assessment to the Labor Code amendments which target improved labor market flexibility. Amendments are concerned with equal treatment of part-time employees, decreased working hours in case of economic problems of companies, flexible working hours for some professions, etc. Maximum working time per week was increased to 48 hours with workers and employees given opportunity to work longer with their consent in writing.

On 26 September the Government, employer organizations' representatives and the syndicates signed a Pact for Economic and Social Development of Bulgaria till the Year 2009. Social priorities for the next year include improved employment up to 58 per cent of the economically active population and decreased unemployment down to 10 per cent of the economically active population. These objectives focus on gradually progressing towards the Lisbon Employment Strategy, 2010, target of over

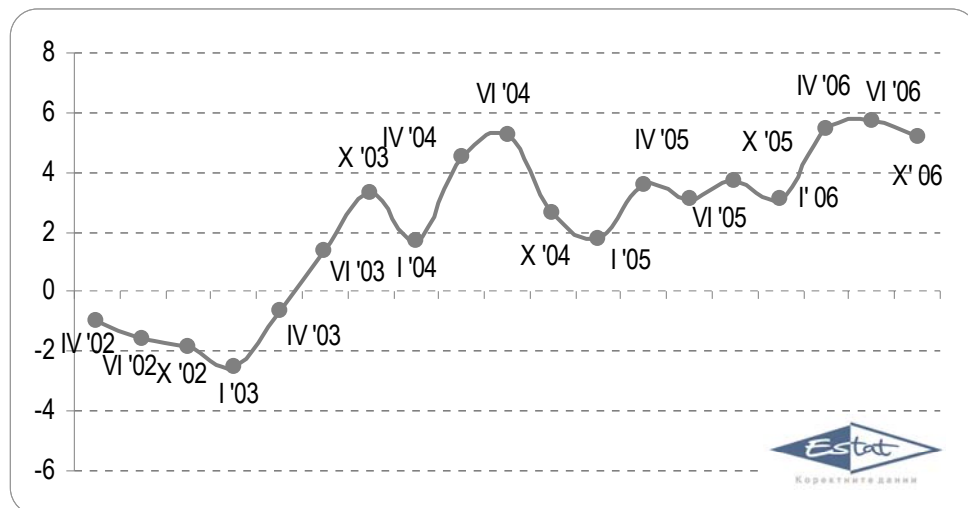
60 per cent employment and below 9 per cent unemployment rate. The plan is to open 240 thousand new jobs and to include 7-8 per cent of the labor force in vocational training (currently training covers a negligible 1 per cent of the economically active population).

## ESTAT Index of Business Climate

↔  
seasonal  
decline of  
Integrated index

**Integrated value of the index.** Having registered a new peak value in July, at the end of the third quarter the ESTAT Index of Business Climate<sup>2</sup> fell to 5.21 in its usual but this time small seasonal decline. The fall is negligible and the value represents no exception to the upward trend registered over the year. It should be noted that three of the levels registered in 2006, including the latest, are above the 5 percentage points mark.

*Figure 3. Business climate dynamics (April 2002 – October 2006)*

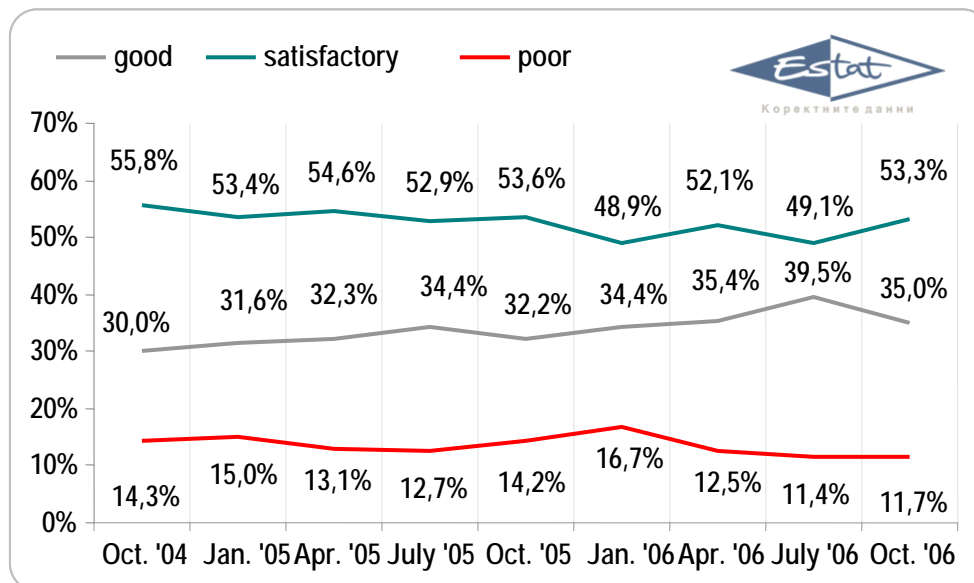


↔  
no changes  
in the  
Company  
Index

Over the whole 2006, **the Company Component** of the index stands at values above 10 percentage points. On the whole, the condition of companies is characterized by absence of significant changes. The share of managers who do not find and do not expect dynamics within the 9-month period assessed by ESTAT reaches record-high levels. Such a situation should be interpreted as indicating sustainable condition of companies.

<sup>2</sup> The survey was conducted in the period 18 September - 4 October 2006 among 412 companies and is representative at the "going concern" level. The sample criteria applied are the region, number of employees and type of ownership. The methodology behind the index and the mathematical model were developed by the Estat Agency for Social and Marketing Surveys.

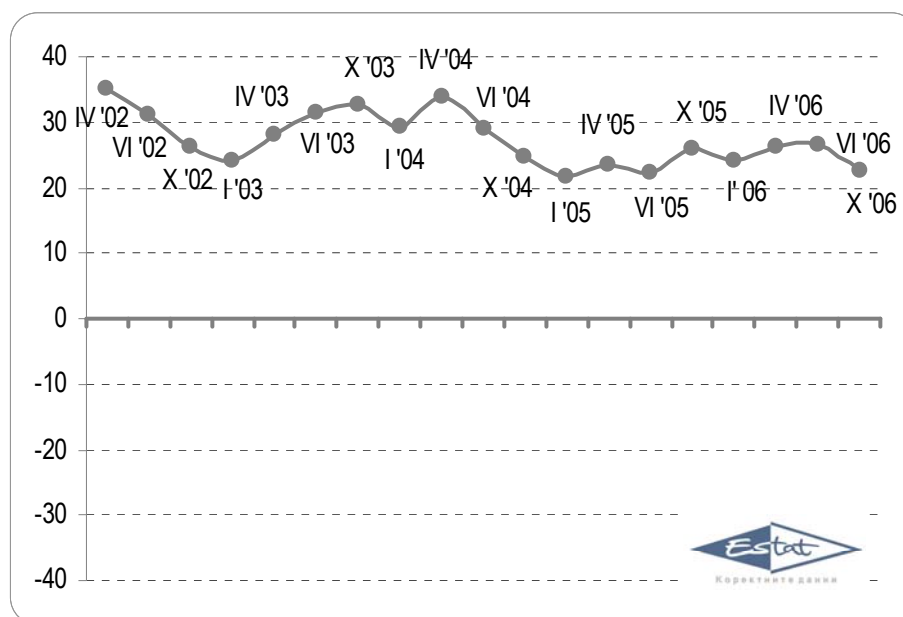
**Figure 4. Condition of Companies Dynamics (October 2004 – October 2006)**



↓  
declining  
investment  
attitudes

**Investment Attitudes Component.** The survey registered aggravation of the decline in investment attitudes observed since July. This conclusion should not raise serious concern, but one has to note also the fact that the value of the Investment Attitudes Component measured in early autumn is the lowest since the beginning of 2005.

**Figure 5. Investment Attitudes Dynamics (April 2002 – October 2006)**





Still in April 2006 ESTAT established that growth in the propensity to invest is smooth and non-persistent, all the more that at that time of the year it should be registering the typical seasonal “bonus”.

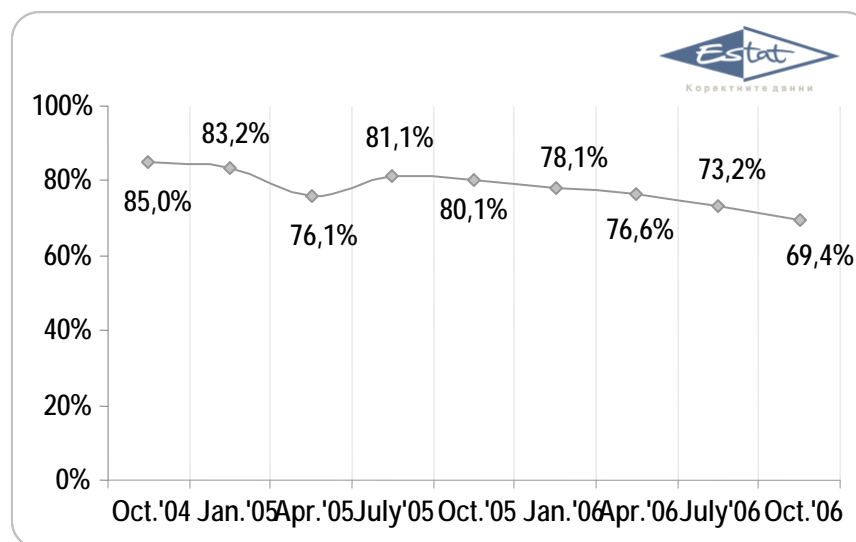
↑  
high assessment  
of the environment

**Business Environment Component.** In October this component registers a record-high value, besides with a notable difference of about 2.5 percentage points between the current and the previous peak value. The unthinkable until recently level of about 15 percentage points is an indicator of a “thaw” of relations between the business and the state – a meaningful fact against the background of the antagonism typical for the past 15 years.

This is also the indicator representing serious resource for improved business environment in Bulgaria and notable future increase of the ESTAT index value. On this basis and with condition of companies and investment attitudes remaining within their usual values, it will be no surprise if the State Component moves up to about negative 10 per cent and the integrated value of the index improves to positive 7-8 percentage points.

The October survey registers positive changes in legislation insofar as the share of entrepreneurs who think that legislation is changing too often and criticize the legislative initiative of the government is on a stable downward trend.

**Figure 6. Share of company managers who agree with the statement “Laws are changing too often” (October 2004 – October 2006)**



## Economic Policy

**Enterprise policy.** Bulgaria’s future full EU membership is a precondition for intensifying the efforts to promote entrepreneurship, improve the regulatory

↓  
preparedness of  
companies for the EU

environment, facilitate public procurement award and implementation procedures, and take proactive measures for counteraction of corruption practices.

The Bulgarian business environment needs to be reformed in order to achieve higher transparency and operability in doing business. **The preparedness of enterprises to operate under the conditions of the Single European Market and their preparation to absorb resources from the structural funds are not at the required level.** This is one area which needs active measures towards development of successful projects and efficient use of financial resources from the European funds.

There is a need of accelerated reforms in the energy and gas sectors. The business and the parliamentary represented political forces support Government's efforts to restructure the state monopolies and increase the market liberalization in these sectors. The latest EC report confirmed that there is will to achieve progress in privatization, concessions and market opening and recommended to the Bulgarian side to keep the pace of implementation of negotiated commitments.

↓  
high fisc  
redistribution

*Public finance.* At the end of the third quarter of 2006, development of public finance is characterized by persistence of major trends established in previous periods. **Among these are: the increase in the actual quota of reallocation through the budget, the sustained chronic budget surpluses and the strengthened role of the state in the Bulgarian economy.** The fiscal policy shall be released from its hesitancy and temptations relating to the possible accumulation of budget surplus, by freeing the Bulgarian economy from taxes and insurance contributions. Unfortunately, in the new draft value added tax, which is to take effect since 1 January 2007, the Parliament and the Government again yielded to the pressure of the tourism lobby. Again the basic idea behind the amendments to PITA is not clear. While the amendments contain some good elements, overall they can be characterized as piecemeal. **The most positive amendment is the lower corporate tax, down from 15 to 10 per cent since 2007.** The long-awaited NRA information system will be implemented. The tax administration leadership is preparing to cope with the budgetary risks relating to Bulgaria's accession to the EU.

↑  
lower  
corporate tax

↔  
length of service  
allowances

*Social and health policy.* Most social policy measures are of declarative nature and are included in the Pact for Economic and Social development of Bulgaria until the Year 2009 signed by the social partners. **The most important task in a labor market perspective – including length of service allowances in the basic wage – is still in a preparatory phase.** Draft wage structure ordinance has been developed. According to the draft, the allowance shall only be payable upon preserved professional experience, i.e. length of service without changing the nature of work. The official poverty threshold, which is to be a decisive parameter in negotiating the minimum wage and social payments in the next year, has not been approved

yet. Some regulatory incentives concerning the working hours took effect since 1 July 2006, including longer maximum working week of 48 hours, increasing the summary calculation period to 6 months and laying down in a regulation the working hours of workers with specific professions. However, according to the European Commission these incentives are insignificant and insufficient to improve labor market flexibility. The difference in positions calls for analyzing the Labor Code effect on labor market flexibility.

↑  
revenues from  
social security  
contributions

Some contradictions between the objective to alleviate the fiscal and security burden on the business and the efforts to implement the social measures with redistributive effect on incomes laid down in the government program emerged during the preparation of Budget 2007. **Despite the lower pension contribution rate, in the first six months of 2006 revenues from social security contributions increased by over 10 per cent against the same period of last year. High elasticity of revenues from social security contributions against the pension contribution rate has been registered, representing one more ground to lower further the social security burden in 2007.** In the next year it will be more difficult to balance social security revenues and expenditures because of the future increase of maternity allowances and the priority indexation of pensions.

↓  
environmental  
infrastructure

*Environmental policy.* Anticipated EC assessment of the preparedness for EU membership and public administration's efforts to prove capacity for implementation of the European legislation in different areas determined the major focal points of the environmental policy. The large number of legislative amendments in the sector in the past few months is mostly of the nature of technical measures adopted towards fuller and more efficient implementation of European directives in different environmental sectors. The view of environmental factors as important elements of the business environment was reflected in the efforts of institutions to find new approach of supporting, consulting and having a dialogue with the business on fulfillment of environmental requirements. At the same time, **the absence of adequate implementation infrastructure for a large number of the measures laid down in the legislation increases and makes more real the risk of failing to achieve the targets negotiated with the EU.** This problem is most valid for the waste management sector.

### Financial Sector

↑  
lower pace  
of credit expansion

*Banking sector.* The banking system dominates the Bulgarian financial sector and financial mediation. In principle, the high pace of credit expansion is a threat to mid- and long-term financial stability. In that light, **the fact that growth in broad money stabilizes at a level of about 20 per cent, which is lower against previous periods, can be given a positive assessment.** In June, BNB began to lift the administrative measures,

positive in our opinion, aimed at curbing credit expansion. In the past quarter BNB continued its intensive efforts towards implementing the European banking standards with a view to Bulgaria's EU membership.

↑  
growth in  
life insurance

*Insurance sector.* In the first six months of 2006 insurance market growth stands at 11.5 per cent, the second quarter being particularly weak for General Insurance which registered a negligible growth of 3 per cent on a year over year basis attributable mainly to a standstill in road motor vehicle insurance sales. On the other hand, the property and financial insurance market registers very positive developments. Assurance preserves a stable high growth, with Life Insurance being a leading contributor to growth.

There will be a new peer review to establish Bulgaria's preparedness to sign the Green Card agreement. The review will focus on running cars with old registration plates and on the stability of the Guarantee Fund. Harmonization of insurance regulations with the Insurance Code is going on. Two new regulations were adopted – one on the accountancy of insurers and their relations with the supervision, whereas users will be the direct beneficiaries under the second as it obligates insurance companies to adopt internal rules for settlement of insurance claims which will facilitate the settlement of damages and will improve the market transparency.

↑  
exchange  
indexes  
↔  
liquidity

*Capital market.* The third quarter of 2006 was characterized by relatively stable turnover values and growth in indexes. Despite that, **the long-term perspectives of notable stir up of liquidity are not clear.** In a short perspective one can expect stir up of the stock markets, insofar as some primary public offerings are being prepared. They are expected to restore the interest of investors who intensively sold out in September.

In order to achieve accelerated growth, there is a need to make concerted efforts both in respect of the initiative to attract quality issuers and towards generally promoting the stock exchange among all potential investors. Important is the preparation for eventual integration in the European exchange structure in light of Bulgaria's accession to the European Union and introduction of the single European Passport in securities since January 2007.

## Main Economic Sectors

↔  
consolidation  
of state  
energy  
companies

*Energy sector.* In the latest amendments to the Energy Act the National Assembly rejected the proposal for direct access of NEK to the own electricity networks of big industrial enterprises. Thus NEK will not be able to circumvent the electricity distribution companies in the supply of electricity to the biggest industrial consumers. On the other hand, the State Energy and Water Regulatory Commission approved new prices for NEK's sales and transmission of electricity to the electricity distribution companies, while leaving unchanged end-user prices. Thus, lowering the

↓  
Burgas -  
Aleksandroupolis

margin of electricity distribution companies, the state found a new gear to ensure higher revenues for NEK. At the end of the past quarter, the Ministry of Economy and Energy announced its intentions to consolidate the state energy companies in one holding structure. Should such mega-structure involving NEK and the state electricity generation plants be realized, the smaller private electricity producers will become uncompetitive, which will impede the development of the free electricity market. In the past quarter, negotiations on the oil pipeline Burgas – Aleksandroupolis were the key international event relating to the state energy policy. The Russian side managed to negotiate a majority share in the project, which weakened the positions of Bulgaria and Greece. Expectations of accelerated project completion can be assessed as rather negative, especially in view of the fact that the Russian side divided its share among three of the big state companies – Transneft, Rosneft, and Gazprom. In Bulgaria, submission of proposals for the privatization of the district heating companies in Plovdiv, Varna and Russe was completed. The new owners of these companies are expected to be appointed in the next three months. For the fourth quarter SEWRC approved new electricity and natural gas prices. New gas prices are not expected to result in higher thermal energy prices.

↑  
National  
strategy

*Transport.* The Council of Ministers made official presentation of the **National Strategy for Integrated Development of Bulgaria's Infrastructure** and the Action Plan, 2006-2015, to it. The main focus is on transport infrastructure development. Of course, approval of such long-term development plan is necessary, but its success is directly depended by the administrative capacity for successful implementation of projects. In the past quarters, a couple of big infrastructure projects registered some progress. A constructor was appointed for the Ljulin Motorway Project, a new section of Trakia Motorway was opened between Karnobat and Burgas (35.2 km), the Danube Bridge 2 Project entered the phase of appointment of a company to design and construct the facility. **Problems in the railway transport sector aggravate. BDZ EAD and NC Railroad Infrastructure were granted additional state subsidy of BGN 20 m. The obsolete and amortized railways and rolling stock need sizable investments.** In the next three years, investments of about EUR 100 m are expected for the seaside airports in Varna and Burgas after the 35 years concession agreement for these airports was signed. A new track was put into operation within the project for modernization and extension of Sofia Airport, but the deadline for opening of the new passenger terminal has not been specified yet. The privatization procedure for Bulgaria Air entered the final phase. Only two companies submitted proposals, largely because of the air market liberalization since 2007. The lack of investors' interest is attributable also to the weak market positions of the air carrier, which has accumulated losses since year start.

↓  
Railway Transport

↑  
foreign  
investments  
in construction  
and real estate

↔  
Calm down  
of prices

*Construction and real estate.* In the first six months of 2006 foreign direct investments in construction and real estate were higher against the value for the whole 2005. Stronger investors' interest towards the real estate market is registered also among special purpose investment funds despite that some market saturation is observed.

The highest level of saturation is registered in residential estates where the increase in prices was minimal at 1.6 per cent according to NSI's data for the second quarter. **Calm down of prices is attributable mainly to high supply which will increase according to data about new building permits issued.** According to NSI's surveys, the business does not expect further increase of real estate prices although construction material prices are going up and investments of construction companies in FTA are on an upward path. House prices are falling in the regions of Kardjali, Russe, Blagoevgrad, Burgas and Plovdiv.

The Law Amending and Supplementing the Law on the Chambers of Architects and Engineers in Investment Design was passed last quarter. The minimum design service prices calculated as a percentage of the project value are replaced by a service cost price threshold, while the ban on combining design and construction activity is lifted. The new territorial plan of Sofia was passed on first reading.

*High technology.* The third quarter of 2006 was relatively calm, with some interesting documents on the condition and development of high technology in Bulgaria published at the end of the period. The fourth e-Bulgaria 2006 report was published. The ICT cluster organized third round table on sector problems and challenges and the "war" on the mobile services market intensified with the in-step of package offers for Internet and mobile communications.

↓  
lower  
growth  
in tourism

*Tourism.* Tourism development continues at a high pace, but with more moderate dynamics compared to previous years. In the period January – August 2006, the number of foreign tourists was up 5.8 per cent against the same period of last year, **which is 1 percentage points lower compared to growth in the period January – August 2005.** Most notable is the growth in the number of tourist from Russia, Romania, Great Britain and the Scandinavian countries. On the other hand, the number of guests from the major market of Bulgarian tourist services – Germany, decreases.

Revenues from international tourism are up 4.62 per cent to EUR 1.2 b and by year end may well go above EUR 2 m against EUR 1.8 b of last year.

The legislation concerning VAT on tourist packages was amended in the period under review. The National Assembly passed a flat VAT rate of 20 per cent for all goods and services in the tourist packages except accommodation for which the rate is 7 per cent. Most probably, mass tourism forms will be encouraged again and the tendency of attracting tourists with lower purchasing power will persist.

The opportunities and positive effects of setting up a Tourism Ministry were intensively commented in the summer season. According to entrepreneurs, such decision would contribute to better management of the tourism sector. The set up of a special ministry will improve the prestige of tourism sector employees and will attribute higher weight to the sector.

*Agriculture.* In the period May – September, all efforts in the agrarian sector were focused on implementing EU requirements towards a positive assessment by EC and preventing the invoking of a safeguard clause. **The minimum program was fulfilled in the long run and agriculture was removed from the “red” zone, but remains under the scrutiny of European observers. There is still much to be done to build the necessary structures for implementation of the Common Agricultural Policy in Bulgaria** and to ensure their efficient operation in order to avoid cutting down of agricultural subsidies. The latest EC monitoring report focuses on the need of immediate action in three directions: (1) building and efficient operation of the Integrated Administration and Control System; (2) implementing the uniform milk production standards and proving the capacity to cope with the classical swine fever, and (3) building new rendering facilities and strict control on the production and use of animal by-products. Fulfillment of all these requirements is expected to improve the organization and efficiency of Bulgarian agriculture and approximate it to the European agrarian production format.

↓ ↑  
preparation for the  
Common Agricultural  
Policy of the EU

### EU Structural Funds and Regional Policy

Intensive efforts on the preparation of Bulgaria for efficient absorption of financial resources from EU's Cohesion Fund and structural funds are going on. A second, substantially redrafted National Strategic Reference Framework has been developed. It contains more precise and reasoned elaboration of the socioeconomic analysis and the development priorities for Bulgaria. A couple of variants for changing planning region borders were discussed in the review period. The Council of Ministers chose a variant of preserving the 6 regions but changing their borders. The Regional Development Law will be amended as well.

↔  
under-  
preparedness  
for EU funds

The Government tries to solve the problem of the financing of municipalities for implementation of European projects. A special fund will be established to support local government since next year.

The sociological surveys conducted in the past months show that the representatives of Bulgarian municipalities and the business are not well prepared to operate with the European funds. This fact again puts on the agenda the need of targeted measures to train and prepare municipal administrations and entrepreneurs to operate with the funds.

### Legislative Amendments Relative to the Economy

The third quarter of 2006 was marked again by intensive legislative activity of the National Assembly in view of the approaching EU membership and the relevant need to fully align the Bulgarian legislation with the *acquis communautaire*. In the third quarter of 2006, major trends in the legislative activity of the Council of Ministers and the National Assembly include on one part passing of new laws which, for the first time and in line with EU requirements, regulate a specific circle of public relations and on the other part, taking further steps to implement e-Government. The most important new laws passed in the period under review are in the area of banking law and consumer protection, namely Law on Financial Security Contracts, Law on Credit Institutions, and Law on Consumer Credit. Ordinance on the Administrative Register, Ordinance on the Terms and Procedure of Electronic Declaring to Customs Authorities, and Ordinance on the Procedure of Building, Implementing, Using and Developing the Automated Information Systems in the Judicial System were promulgated towards further implementation of e-Government. Many important amendments and supplements to the regulations on small and medium-sized enterprises, labor and social security relations, intellectual property, and the energy sector were passed as well.